78-1168

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-

MONTE J. WALLACE AND NEIL W. WALLACE,
Petitioners,
v.

SECURITIES AND EXCHANGE COMMISSION, CONTINENTAL INVESTMENT CORPORATION, AND CREDITORS COMMITTEE OF CONTINENTAL INVESTMENT CORPORATION,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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Monte J. Wallace and Neil W. Wallace petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the First Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals (Appendix A) is reported at 586 F.2d 241. That opinion affirmed a decision of the United States District Court for the District of Massachusetts (Appendix B) which has not been reported. The District Court's decision had reversed an unreported decision of the Bankruptcy Court (Appendix C) denying transfer of this matter from Chapter XI of the Bankruptcy Act to Chapter X.

JURISDICTION

The judgment of the Court of Appeals (App. A at 17a) was entered on October 27, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED

Does the Bankruptcy Act delegate to the Securities and Exchange Commission the power to preclude confirmation of a negotiated plan of arrangement under Chapter XI which is found both to be fair and feasible and to serve the needs of the public creditors solely because the arrangement may significantly affect those public creditors?

STATUTORY PROVISIONS INVOLVED

Sections 141, 146, and 328 of the Bankruptcy Act, 11 U.S.C. §§ 541, 546, and 728, are set forth in Appendix D.

STATEMENT

Petitioners own or control sixty-five percent of the common stock of Continental Investment Corporation ("CIC"). On April 30, 1976, CIC filed a petition seeking an arrangement under Chapter XI of the Bankruptcy Act. On November 9, 1976, the Bankruptcy Court denied a motion by the Securities and Exchange Commission ("SEC") to transfer the proceeding to Chapter X, and on November 30, the Bankruptcy Court confirmed CIC's plan of arrangement under Chapter XI.[1] The needs of CIC's public debtholders were protected under

[1] CIC's petition is attached to the Bankruptcy Court's Order confirming CIC's Chapter XI plan of arrangement. That Order is reproduced as Appendix E.

the Chapter XI plan, as the Bankruptcy Court's opinion denying transfer reflects, by effective organization by major holders of the public debt, negotiation of the proposed plan of arrangement by experienced businessmen representing institutions holding a substantial portion of that debt, and agreement by all parties with an economic interest upon a plan of arrangement that includes provisions to control or replace management if the need to do so arises.

In addition, the Bankruptcy Court found that

> (i) the proposed plan of arrangement was feasible, fair, and in the best interests of the creditors, and that there was no evidence that more favorable terms for the public debtholders could have been negotiated;
>
> (ii) there was no demonstration that new management was needed;
>
> (iii) there was no showing of a need, in light of an investigation already performed by a committee of creditors, for any further investigation of the acts of the company or of its management; and
>
> (iv) the debtor's shareholders and debtholders overwhelmingly approved the proposed Chapter XI plan of arrangement after full disclosure of all material facts.

On March 31, 1978, the District Court set aside the confirmation and ordered the proceeding transferred to Chapter X, and on October 27, 1978, the Court of Appeals affirmed the District Court's decision. The District Court and the Court of Appeals did not set aside any of these findings by Bankruptcy Court. Rather, the basis for their decisions holding CIC ineligible for Chapter XI relief was their belief that "major reorganizations of publicly held debt where the investors are many and widespread must proceed in Chapter X." (App. A at 16a, 20.)

A. Facts

CIC is a diversified financial services company operating entirely through subsidiary corporations. Its capital structure is relatively simple. It has senior debt, approximately $61,000,000 as of June 30, 1975, held by 16 banks. (App. A at 3a.) It has outstanding subordinated debenture indebtedness, in the aggregate principal amount of approximately $38,500,000 as of May 1, 1975, which is held by approximately 1,600 holders of record. Finally, CIC has outstanding approximately 13,000,000 shares of common stock held by approximately 4,100 holders of record. (App. C at 2c.)

In 1974, CIC defaulted on its bank debt and its subordinated debentures. CIC thereupon entered into extensive negotiations with its lending banks, a Debentureholders Protective Committee formed by institutional holders of about 10 percent of the outstanding debentures, and two pension funds that together held an additional 16 percent of the outstanding debentures. (App. A at 3a.) At the same time, counsel for the Debentureholders Protective Committee conducted an independent investigation into the affairs of CIC. (App. C at 3c.)

CIC's creditors deliberately avoided Chapter X. They feared that the cumbersome, lengthy, and expensive procedures of Chapter X would (i) unduly disrupt CIC's business, (ii) risk the loss of a valuable tax loss carryforward, and (iii) risk the cancellation of valuable investment advisory contracts held by CIC's investment advisor subsidiary Waddell & Reed, a loss that would also disrupt the business of other profitable CIC subsidiaries that use Waddell and Reed salesmen to sell insurance and interests in oil and gas partnerships. (App. C at 4c.) On July 29, 1975, CIC, its bank lenders and the representatives of the debentureholders reached agreement in principle on a proposed restructuring of CIC based on an arrangement under Chapter XI. (App. A at 3a.)

CIC's Chapter XI plan of rehabilitation was designed, as the Court of Appeals later observed,

> "to greatly reduce CIC's annual debt service obligations. Combined with steps already taken by management to divest CIC of marginal and unprofitable subsidiaries and to reduce costs, the parties hope to return CIC to profitable operation. Indeed CIC has been able to produce positive operating revenue in 1976 and 1977." (*Id.* at 4a.)

Under the Chapter XI plan the unsecured debentureholders are to receive subordinated debentures and two classes of preferred stock.[2] Outside the Chapter XI plan, but in conjunction with it, CIC's bank debt was reduced by $34,000,000 through foreclosure of a security interest in stock of a former CIC subsidiary on April 27, 1976. (App. C at 3c.) Contingent on confirmation of the Chapter XI plan of arrangement, the banks are to receive notes and stock in exchange for the remaining secured indebtedness.[3]

The proposed restructuring contemplated solicitation of debentureholder consents and shareholder approval. Accordingly, representatives of CIC and the debenture-

---

[2] The debentureholders are to receive (i) $3,500,000 in Subordinated Interest-Inclusive Debentures due 1984; (ii) 1,125,000 shares of Junior Preferred Stock with a liquidation preference/redemption price of $20 per share and attached warrants to purchase 1,780,000 shares of common stock of CIC; and (iii) 800,000 shares of Convertible Preferred Stock with a liquidation preference/redemption price of $20 per share, convertible into 4,000,000 shares of common stock of CIC. App. A at 3a-4a.

[3] The banks are to receive Senior Term Notes in the principal amount of $20,000,000, along with 350,000 shares of Senior Preferred Stock with a liquidation preference/redemption price of $20 per share and attached warrants to purchase 600,000 shares of CIC common stock. *Id.* at 3a.

holders met with the SEC in August and September of 1975 and presented the proposed plan. On September 29, 1975, CIC filed with the SEC, in preliminary form, a combined Registration Statement under the Securities Act of 1933 and Proxy Statement under the Securities Exchange Act of 1934. Discussions between CIC and the SEC staff concerning the content of the combined filing continued for approximately six months. Although the proposed plan clearly contemplated proceedings under Chapter XI,[4] at no time during this period did the Commission advise CIC of any intention to file a motion to transfer to Chapter X if CIC attempted to have the proposed plan confirmed under Chapter XI. (*Id.* at 5c.)

When the SEC cleared the Registration Statement, in March 1976, CIC promptly solicited consents from its debentureholders and proxies from its shareholders. The plan was approved by approximately 89 percent of all shares outstanding, and consents were initially received from holders of approximately 82 percent in number and in amount of CIC's outstanding subordinated debentures. By the time of the District Court's decision, approximately 90 percent of the debentureholders had consented. (App. A at 3a.)

As the Court of Appeals concluded, each group agreed to "sacrifices" in order to secure the Chapter XI plan. (*Id.* at 11a.) The secured bank debtholders agreed to forego interest claims, to take stock of a CIC subsidiary in partial satisfaction of CIC's debt, and to accept notes and preferred stock in satisfaction of the remainder. The debentureholders agreed to forego interest claims and a claim to a substantial portion of the equity interest in CIC. The common stockholders agreed to give the debentureholders the power to elect a majority of the

[4] *E.g.*, Continental Investment Corporation Prospectus, March 19, 1976, at ii. The Prospectus is included in the Consolidated Record Appendix on Appeal (filed in the Court of Appeals) at pp. 137-394.

board of directors, and subjected their equity share in the company to a substantial (approximately one-third) dilution.[5] Considering these and other details of the plan the Bankruptcy Court found that "[t]he terms of the securities to be issued in exchange for the publicly held debt appear to be fair to the holders thereof." (App. C at 6c.) By their votes and consents, as well as by their position on appeal, the securityholders appear to have agreed.

B. Litigation

On April 30, 1976, CIC filed its Chapter XI petition in the U.S. District Court for the District of Massachusetts. The District Court had jurisdiction under 28 U.S.C. § 1334. The petition was filed in Chapter XI under authority of Bankruptcy Act § 322, 11 U.S.C. § 722. The petition proposed the arrangement that had already been approved by shareholder vote and consented to by the debentureholders.

On June 18, 1976, the SEC moved under Section 328 of the Bankruptcy Act, 11 U.S.C. § 728, to transfer the case to Chapter X. No party in interest joined the SEC's motion. The Bankruptcy Court, to which the case had been assigned, and which had already held a hearing on confirmation, held an additional hearing on the motion to transfer on August 3, 1976, and admitted various affidavits and documentary materials into evidence. On November 9, 1976, the Bankruptcy Court denied the SEC's motion. (App. C.) Three weeks later it confirmed CIC's Chapter XI plan. (App. E.)

In its decision denying the SEC's transfer motion, the Bankruptcy Court found as a fact that the Chapter XI plan was "feasible and in the best interests

[5] *See id.* at 4a. Six members of the eleven member board of directors are to be elected by the holders of the convertible preferred stock (the debentureholders), and four by the holders of the common stock. The eleventh director is to be selected by the initial ten.

of the creditors"; that the terms of the exchange of securities for the subordinated debentures were "fair"; that there was no evidence that "terms more favorable to the public debtholders could have been negotiated"; and that the Chapter XI plan eliminated any need "to take any action affecting the rights of secured creditors or holders of certificates of beneficial interest" except implementation of the refinancing agreement between CIC and its bank creditors, which it recognized would "require no further action by the Court." (App. C at 6c, 7c (emphasis deleted).) The Bankruptcy Court also determined that there was "no evidence of wrongdoing on the part of management of the debtor"; that in light of the investigation already conducted there was no need of any further investigation into the propriety of any past acts of CIC or its mangement by an independent trustee; and that there was insufficient evidence "to warrant a finding that new management of the debtor is needed." (*Id.* at 7c.) Judging from these facts and an assessment of the "needs to be served" in the bankruptcy proceeding, *see General Stores Corp.* v. *Shlensky*, 350 U.S. 462 (1956), the Bankruptcy Court found that there was insufficient evidence "to warrant a finding that relief under Chapter XI of the Bankruptcy Act would not be adequate." (App. C at 7c.)

The SEC appealed the denial of its motion to the District Court. The District Court reversed the decision of the Bankruptcy Court, resting its conclusion on "the general rule that proceedings for adjustment of publicly held debt should appropriately be in Chapter X." (App. B at 7b.)

Petitioners, CIC, and the Creditors Committee all appealed. On October 27, 1978, the Court of Appeals affirmed. It held that "the Supreme Court has established a two-step test to determine whether a corporate rehabilitation affecting publicly held debt can go forward

in Chapter XI or must be transferred to Chapter X." (App. A at 9a.) The Court of Appeals then concluded that CIC had not satisfied the first step because its Chapter XI plan included a "major [reorganization] of publicly held debt where the investors are many and widespread." (*Id.* at 16a.) The Court of Appeals therefore did not even consider what it regarded as the second step—a weighing of each of the factors relating to the "needs to be served" by the bankruptcy process.

REASON FOR GRANTING THE WRIT

Certiorari Should Be Granted Because the Court of Appeals' Decision Conflicts With Applicable Decisions of This Court and Other Courts of Appeals on an Important Question Regarding Administration of the Bankruptcy Laws.

This Court has three times considered the principles for deciding whether Chapter X or Chapter XI is the appropriate vehicle for reorganization in a given case. *SEC* v. *American Trailer Rentals Co.*, 379 U.S. 594 (1965); *General Stores Corp.* v. *Shlensky*, 350 U.S. 462 (1956); *SEC* v. *United States Realty & Improvement Co.*, 310 U.S. 434 (1940). The choice between Chapter X and Chapter XI is invariably an important one because of the expense, disruption, and delay inherent in Chapter X's cumbersome procedures. Hence, in every case the question is unavoidable whether the huge "transaction costs" imposed by Chapter X—which reduce the total amount available to be shared among creditors and owners—can be justified by a real need to provide the formal protections of Chapter X. Contrary to the rule laid down by the Court of Appeals in this case, Chapter X imposes severe costs on both the debtor and the courts. A trustee must be appointed (11 U.S.C. § 556); he must conduct an investigation under court

[the answer to that question is not automatic.]

supervision into the affairs of the debtor (§ 567); he must prepare a plan of reorganization (§ 569); the SEC must comment on the plan to the court (§ 572); and the court must determine that the plan is "fair and equitable" (meaning that the plan adheres to the rule of "absolute priority") and feasible (§§ 574, 621) before shareholder and creditor approval for the plan is solicited (§ 576).

By contrast, Chapter XI relies primarily on private negotiation to develop a plan and the business judgment of affected persons to protect their own interests. The debtor typically remains in possession and its management is responsible for formulation of a plan (§§ 706(1), 723, 742, 757); if the necessary consents are obtained, the court need only find that the plan is feasible and in the best interests of the creditors before it orders that the plan be implemented (§ 766).

The Bankruptcy Act does not specify any criteria for determining whether Chapter X or Chapter XI is appropriate in any given case. It does, however, imply some preference for the simpler Chapter XI by providing that filing in Chapter X is improper if "adequate relief would be obtainable . . . under the provisions of chapter XI. . . ." (§ 546.)

In *SEC* v. *American Trailer Rentals Co.*, 379 U.S. 594 (1965), this Court recognized that, as a general rule, restructuring a large company with widespread public securityholders will require the mechanisms of Chapter X. But that opinion also makes it absolutely plain that the choice between Chapter X or Chapter XI is not determined simply by the size of the company or the structure of its debt. Rather, it depends on whether, in the circumstances of the case, the needs of the securityholders and the debtor require that the more onerous Chapter X proceedings be imposed on the debtor and the courts. *Id.* at 607-613; *see General Stores Corp.* v. *Shlensky*, 350 U.S. 462, 466 (1956). Moreover, the fundamental question in assessing the "needs to be served" is whether

> "the investing public dissociated from control or active participation in the management, needs impartial and expert administrative assistance in the ascertainment of facts, in the detection of fraud, and in the understanding of complex financial problems"

that can be obtained only from the more cumbersome Chapter X procedures. *American Trailer Rentals*, 379 U.S. at 608, *quoting United States Realty & Improvement Co.*, 310 U.S. at 448-49 n.6. Transfer to Chapter X is inappropriate if the safeguards afforded under Chapter X can be satisfied in a Chapter XI proceeding, even though the proposed restructuring affects the rights of public shareholders or creditors. *E.g.*, *In re KDI Corp.*, 477 F.2d 726, 735 (6th Cir. 1973); *SEC* v. *Crumpton Builders, Inc.*, 337 F.2d 907, 911 (5th Cir. 1964).

In this case, despite the Bankruptcy Court's conclusion that the "needs to be served" were adequately served in CIC's Chapter XI proceeding and the overwhelming approval of the parties in interest, the Court of Appeals (and the District Court) concluded that *American Trailer Rentals* established an absolute rule that a significant restructuring of widespread public debt must proceed in Chapter X. This holding is in fact contrary to the principles enunciated in *American Trailer Rentals* and in this Court's other decisions.

American Trailer Rentals indicates that an assessment of the "needs to be served" in a bankruptcy reorganization must include such diverse

> "factors as requirements of fairness to public debtholders, need for a trustee's evaluation of an accounting from management or determination that new management is necessary, and the need to readjust a complicated debt structure requiring more than a

simple composition of unsecured debt." 379 U.S. at 610.

But the Court of Appeals in this case singled out the last of these examples—"the need to readjust a complicated debt structure . . ."—and held that "this one factor requires transfer to Chapter X." (App. A at 9a.) Thus the Court of Appeals transformed what this Court advanced in *American Trailer Rentals* as a "general rule" admitting of exceptions, 379 U.S. at 613, 616, into the sort of "absolute rule" that neither Congress, nor this Court, intended. *Id.* at 613.[6]

The Court of Appeals reached this erroneous conclusion because it read *American Trailer Rentals* to lay down a mechanical rule that only a "simple composition" may proceed in Chapter XI. (App. A at 9a.) But *American Trailer Rentals* does not hold that a rehabilitation plan that is capable of being carried out under Chapter XI must be transferred to Chapter X merely because it is complex or substantial. To the contrary, while Chapter XI's scope will sometimes be inadequate to accommodate needed changes, *American Trailer Rentals* recognizes the requirement for a determination in each case of "the needs to be served": "A Chapter X petition

[6] The Court of Appeals relied heavily on the statement in *American Trailer Rentals* that in that case

> "public debts [were] being adjusted. The investors [were] many and widespread, not few in number intimately connected with the debtor, and the adjustment is quite major and certainly not minor. These facts alone would require Chapter X proceedings under the above-stated principles." 379 U.S. at 615.

The Court of Appeals took this passage to mean that the complicated debt reorganization contemplated in that case, by itself, required as a matter of law that the matter proceed in Chapter X. But the Court of Appeals appears to have misread the case. In the quoted passage the Court was addressing only the "general rule" that complicated reorganizations call for Chapter X, a rule which admits of exception where the needs to be served can be satisfied in Chapter XI. Indeed, the next paragraph of the Court's opinion (on p. 616), which speaks of the "general rule," appears to confirm that the Court of Appeals' reading is incorrect.

may not be filed unless 'adequate relief' is not obtainable under Chapter XI [Bankruptcy Act] § 146(2) [11 U.S.C. § 546(2)]." 379 U.S. at 607. And the adequacy of relief obtainable under Chapter XI depends on "the needs to be served." Since these needs are met by the Chapter XI procedure followed in this case, transfer to Chapter X was not proper.[7]

The mechanical rule adopted by the Court of Appeals is not only inconsistent with *American Trailer Rentals*, it is also in irreconcilable conflict with decisions from other Courts of Appeals.[8] For example, the Third Circuit permitted the Penn Central Company, the publicly owned parent of the Penn Central Railroad, to be reorganized in Chapter XI, on the ground that "no absolute rule governs whether a reorganization should be accomplished under Chapter XI." *In re Penn Central Co.*, Nos. 78-1715, 78-2321, 78-2336, slip op. at 24 n.10

[7] *American Trailer Rentals* observers in *dicta* that

> "Chapter X is still the appropriate proceeding where the debtor has widespread public stockholders and the protection of the public and private interests involved afforded by Chapter X are required because, for example, there is evidence of management misdeeds for which an accounting might be made, there is need for a new management, or the financial condition of the debtor requires more than a simple composition of its unsecured debts." 379 U.S. at 615.

Obviously this passage does not mean that incidence of one of the three enumerated factors would absolutely require proceeding in Chapter X if Chapter X type protections can be otherwise secured. For example, if management was faulty but has already been replaced, then there may be no need for Chapter X. *E.g., In re KDI Corp.*, 477 F.2d 726, 738 (6th Cir. 1972). Similarly, where a restructuring of debt may be substantial, but all the public and private interests involved have been adequately protected by alternative procedures, Chapter X procedures need not be invoked.

[8] Other courts are in general agreement that the "general rule" of *American Trailer Rentals* and its antecedents is merely a corollary of the "needs" analysis. *See, e.g., Norman Finance & Thrift Corp.* v. *SEC*, 415 F.2d 1199 (10th Cir. 1969); *In re Peoples Loan & Investment Co.*, 410 F.2d 851 (8th Cir. 1969).

(3d Cir. Jan. 11, 1979). Similarly, in *In re Alrac Corp.*, 550 F.2d 1314 (2d Cir. 1977), the debtor was permitted to proceed in Chapter XI even though its Chapter XI arrangement called for issuance of 1.5 million new shares in the debtor, and would affect the debtor's publicly held debt. The Second Circuit approved Chapter XI proceedings in *Alrac* primarily on the grounds that (1) "there was no assurance that the debtor would survive the rigors of Chapter X"; (2) "there was no need for an independent trustee"; (3) the "Chapter XI arrangement [was] overwhelmingly approved by the holders of the debtor's public debt"; and (4) "the adjustment of publicly held debt was not so substantial as to outweigh the factors favoring Chapter XI treatment." 550 F.2d at 1319.[9]

The Court of Appeals' decision is unreasonable as well. The effect of the rigid rule advanced by the Court of Appeals is to require the Bankruptcy Court to re-open and re-resolve problems that have already been worked out in a fair and pragmatic fashion to the satisfaction of all those who have an economic interest in the debtor. While the Court of Appeals believed that its rigid rule approach had the "merit of simplicity," in fact it represents a false economy. The Court of Appeals' approach may simplify its own task, but it does so only by saddling interested parties, Bankruptcy Courts, and District Courts with inherently complex, invariably lengthy, and

[9] The Court of Appeals attempted to distinguish *Alrac*, and thus to avoid a conflict. But in discussing the substantiality and impact of the *Alrac* plan of arrangement, the Court of Appeals' analysis ignores the fact that that arrangement involved issuance of 1.5 million shares of stock (more than the 1,043,056 already outstanding), which would quite obviously affect the 1,500 equity owners of the corporation. Even more fundamentally, the Court of Appeals' rigid approach in this case is simply irreconcilable with the *Alrac* court's flexible weighing of the "substantiality" of the adjustment of publicly held debt against "the factors favoring Chapter XI treatment." 550 F.2d at 1319.

wholly avoidable Chapter X proceedings in cases that could adequately be resolved in Chapter XI.

In addition, review of this case is important to preclude the SEC from usurping the judiciary's role in determining whether Chapter X or Chapter XI is the appropriate vehicle for relief in a given case. The SEC contends that it has discretion to decide whether or not to move to transfer a case to Chapter X, and it has acknowledged that it often declines to move to transfer, even when the debtor is a large company and substantial and complex restructuring of publicly held debt is required, "where it appears that in a particular Chapter XI case the public investors are fairly treated." [10] At the same time, however, the SEC contends that when it does decide to move to transfer its motion must be granted automatically.

Noting SEC practice in this regard, the House Report on the Bankruptcy Reform Act of 1978 critically observed that usually "a motion for conversion [from Chapter XI to Chapter X] by the Securities and Exchange Commission . . . is used as a bargaining tool to extract concessions from a debtor in the formulation of the plan." [11] While this alone might not be enough to warrant review, the practical effect of the rule adopted in this case is. For it permits the SEC to do precisely what it contends the bankruptcy courts cannot do—evaluate whether, in the circumstances of a given case, the needs of the public or other circumstances require the more onerous procedures of Chapter X, or whether Chapter XI proceedings may be adequate.[12] It is difficult to recon-

[10] SEC Brief on Appeal, p. 49.

[11] H.R. Rep. No. 595, 95th Cong., 1st Sess. 223 (1977).

[12] Many complicated restructurings of publicly held debt in Chapter XI have gone unchallenged by the SEC. Some of these cases are summarized in the District Court Brief of Debtor/Appellee Continental Investment Corporation, Appendix A (January 17,

cile the absolute rule advocated by the SEC in the cases it chooses to litigate and adopted by the Court of Appeals —that fairness to public debtholders always requires Chapter X treatment for significant restructurings— with the SEC's own more flexible and pragmatic practice.

Congress' enactment of the Bankruptcy Reform Act of 1978, 92 Stat. 2549 (1978), further demonstrates the appropriateness of review in this case. The legislative history of this new statute demonstrates clearly Congress' approval of the use of Chapter XI procedures in cases such as CIC's even before passage of the Reform Act, as well as Congress' intent to permit restructurings such as CIC's in the future to utilize flexible new facilities that are far more akin to Chapter XI than to Chapter X.[13]

In enacting the Reform Act, the terms of which become effective in October 1979, Congress abolished Chapter X. A bill supported by the SEC, which would have singled out "public companies" for special Chapter X-like treatment, was abandoned by Congress in favor of a single general procedure in all cases. In adopting this approach Congress expressly rejected "the myth

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1977), a copy of which is reproduced as Appendix F to this petition. Indeed, the interested parties in this case believed that the SEC would not attempt to force CIC into Chapter X. As the Bankruptcy Judge found, the SEC did not advise CIC during the six months of negotiations concerning CIC's solicitation materials that it would seek to have the case transferred to Chapter X. App. C at 5c.

[13] In a letter to the Clerk of the Court of Appeals dated October 26, 1978 (Appendix G), Counsel for CIC invited the Court of Appeals' attention to the legislative history of the Reform Act even before it was signed into law by the President. The Court of Appeals' printed opinion was issued the following day, October 27, 1978, however, and thus did not take note of those legislative developments. *See* App. A at 2a. The Court of Appeals entered an order noting a technical correction to its opinion on October 31, 1978, but that correction also does not address the legislative history of the Reform Act, which had not yet been enacted. *Id.* at 19a.

that provisions similar to those contained in Chapter X are necessary for the protection of public investors." [14]

Congress rejected the Chapter X model in its Reform Act because disclosure requirements and other developments in securities regulation introduced since enactment of the Chandler Act in 1938 independently assure public investors much of the protection sought to be afforded in Chapter X; [15] because Chapter X-type procedures almost inevitably involve costly (and sometimes disastrous) delay that injures creditors and debtors alike; [16] and because such "complicated and time-consuming provisions" are "not always necessary for the successful reorganization of a company with public debt." [17] Rather, Congress found that "the more flexible provisions in Chapter XI permit a debtor to obtain relief under the Bankruptcy Act in significantly less time than is required to confirm a plan of reorganization under Chapter X. . . ." [18], and that "[o]ne cannot overemphasize the advantages of speed and simplicity to both creditors and debtors." [19]

The same reasons, of course, militate in favor of proceeding in Chapter XI rather than Chapter X under existing law when the "needs to be served" can be and

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[14] 124 Cong. Rec. S17,418 (daily ed. Oct. 6, 1978) (remarks of Sen. DeConcini); *id.* at H11,100 (daily ed. Sept. 28, 1978) (remarks of Rep. Edwards). There was no Conference Report on the Reform Act; the remarks of Senator DeConcini and Representative Edwards, the Committee Chairmen in charge of the legislation, took the place of a conference report and should be accorded similar respect. *Id.* at H11,088 (remarks of Rep. Rousselot).

[15] *Id.* at S17,418 (daily ed. October 6, 1978) (DeConcini); *id.* at H11,102 (daily ed. Sept. 28, 1978) (Rep. Edwards).

[16] *Id.* at S17,418 (DeConcini); *id.* at H11,102 (Edwards).

[17] *Id.* at S17,418 (DeConcini); *id.* at H11,102 (Edwards).

[18] *Id.* at S17,418 (DeConcini); *id.* at H11,102 (Edwards).

[19] *Id.* at S17,418 (DeConcini); *id.* at H11,102 (Edwards).

have been served in Chapter XI. Indeed, Congress specifically cited with approval in the legislative history of the Reform Act a number of cases under existing law in which publicly held companies of substantial size had sought restructuring in Chapter XI.[20] This Congressional action confirms the correctness of the Bankruptcy Court's decision in refusing to require CIC to proceed in Chapter X. Even if the law were previously open to some doubt it is clear that the existing statutory provisions should now be interpreted to conform with the policy of Congress' most recent enactments—and thus to permit CIC's reorganization in Chapter XI.[21]

Unfortunately, however, enactment of the Reform Act alone will not lay to rest the mechanical rule adopted by the Court of Appeals in this case. While the Reform Act eliminates Chapter X, it resurrects the problem of choosing between Chapter X and Chapter XI in only slightly different clothes: Under the new Chapter XI the Bankruptcy Court will be required to decide in cases like this one whether or not "cause" exists to appoint a trustee. Bankruptcy Reform Act of 1978, § 1104(a), 92 Stat. 2627. Left unreviewed, the likelihood is substantial that the mechanical rule adopted by the Court of Appeals in this case will be applied by courts seeking to determine when "cause" exists under the Reform Act provisions to appoint a trustee. Indeed, this is precisely what the SEC said when it proposed that Congress adopt the SEC approach in the Reform Act. The SEC specifically warned that the issues arising in litigation over transfer between Chapter XI and Chapter X "will only

[20] *See id.* at S17,418 (Sen. DeConcini: referring to cases of Daylin, Inc.; Colwell Mortgage Investors; National Mortgage Fund; Esgrow, Inc.; Sherwood Diversified Services, Inc.; Sheffield Watch Corp.; and United Merchants and Manufacturers, Inc.); *id.* at H11,101-02 (Edwards: referring to same cases).

[21] *E.g., In re petition of Chin Thloot Har Wong*, 224 F. Supp. 155 (S.D.N.Y. 1963).

shift . . . to the need for the appointment" of a trustee under the new statute.[22]

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to review the judgment and opinion of the Court of Appeals for the First Circuit.

Respectfully submitted,

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[22] *Hearings on S. 2266 and H.R. 8200 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 95th Cong., 1st Sess. 624 (1977). The SEC's comments were offered in support of a bill that would specify that a trustee would be appointed in each case involving a "public company," defined as a company with 1,000 or more securityholders and $5,000,000 or more in certain debts. The SEC's comments were directed specifically against the House bill, H.R. 8200, which, as it then stood, provided only very general standards for determining whether a trustee should or should not be appointed. H.R. 8200 was subsequently amended, before it was enacted, to provide that "the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor" are not to be taken into account in determining whether a trustee should be appointed. Bankruptcy Reform Act of 1978, §§ 1104(a)(1) and (2), 92 Stat. 2627. Sections 1104 (a)(1) and (2) do not specifically address the kind of absolute rule adopted by the Court of Appeals, however.